

STATE OF IOWA  
DEPARTMENT OF COMMERCE  
UTILITIES BOARD

IN RE:  GLOBAL CROSSING LTD. AND CITIZENS COMMUNICATIONS COMPANY	DOCKET NO. SPU-00-15
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**ORDER APPROVING SETTLEMENT, ESTABLISHING REPORTING  
REQUIREMENTS, AND TERMINATING DOCKET**

(Issued January 16, 2001)

On August 16, 2000, Global Crossing Ltd. (Global) and Citizens Communications Company (Citizens) filed a proposal for reorganization pursuant to the provisions of Iowa Code § 476.77 (1999). The reorganization involved the sale of the capital stock of Frontier Subsidiary Telco, Inc., from Global to Citizens. Frontier Subsidiary Telco, Inc., is the parent of Frontier Communications of Iowa, Inc. (Frontier-Iowa), a local exchange company, and Frontier Communications of America, Inc. (FCA), an interexchange and competitive local exchange carrier. After the sale, Frontier-Iowa and FCA would remain wholly-owned subsidiaries of Frontier Subsidiary Telco, Inc.

On September 14, 2000, the Utilities Board (Board) issued an order docketing the filing and establishing a procedural schedule for interventions, the filing of testimony, and a hearing. No applications to intervene were filed.

On September 22, 2000, Citizens, Global, and the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a "Joint Motion For Approval Of Settlement Agreement," which purported to resolve all of the issues concerning the reorganization. On October 13, 2000, the Board issued an order requesting the parties provide additional information. The responses were filed on October 19, 2000. The hearing was held on October 26, 2000, as scheduled, for presentation of the settlement and for Board questions.

On November 7, 2000, the Board issued an "Order Providing Notice of Ex Parte Letters, Scheduling Responses, and Extending Deadline." In the order the Board gave notice to the parties that the Board had received an ex parte contact from the Communications Workers of America (CWA) concerning the testimony of Citizens witness Peterson. The Board also gave notice of a prior attempted ex parte contact by CWA. The Board allowed the parties to respond to both letters on or before November 17, 2000. The Board set out two primary questions for the parties to address. The first question was whether the matter raised by CWA is material to the disposition of the proposed reorganization. The second question was whether Mr. Peterson's testimony was complete and truthful.

In the November 7 order the Board also extended the deadline for issuing a decision concerning the proposed reorganization from November 14, 2000, to January 16, 2001. Iowa Code § 476.77(2) (1999) authorizes the Board to extend the deadline for issuing an order up to an additional 90 days.

On November 16, 2000, Consumer Advocate filed its response to the Board's November 7th order. On November 17, 2000, Citizens filed its response. The issues concerning the ex parte contact and the issues raised are addressed below. The Board will first address the statutory factors for determining whether the reorganization should not be disapproved.

### **STATUTORY FACTORS**

Iowa Code § 476.77(2) establishes five factors to be considered by the Board when it reviews a proposed reorganization. The five statutory factors are addressed below. In addressing compliance with the statutory factors, the Board will consider the settlement agreement, the documents filed in support of the proposed reorganization, and the testimony of the witnesses at the hearing.

**1. WHETHER THE BOARD WILL HAVE REASONABLE ACCESS TO BOOKS, RECORDS, DOCUMENTS, AND OTHER INFORMATION RELATING TO THE PUBLIC UTILITY OR ANY OF ITS AFFILIATES. (Iowa Code § 476.77(2)"a")**

Citizens stated in its initial filing that the books and records of Frontier-Iowa would remain at their present location and will be available to the Board. Citizens stated that if there is a change in the location of the books and records, Citizens will assure reasonable access in accord with the Board's rules in Chapter 18. Retention of the books and records at their current location and access if they are moved was affirmed by Citizens witnesses at the hearing.

The Board finds that retention of the Frontier-Iowa books and records at their current location provides reasonable access and future access is assured by Citizens' commitment to comply with 199 IAC 18. Since Citizens is also a regulated local exchange carrier, the Board believes that there will be reasonable access to its books and records and those of Frontier-Iowa affiliates.

**2. WHETHER THE PUBLIC UTILITY'S ABILITY TO ATTRACT CAPITAL ON REASONABLE TERMS, INCLUDING THE MAINTENANCE OF A REASONABLE CAPITAL STRUCTURE, IS IMPAIRED. (476.77(3)“b”)**

The settlement agreement requires Citizens to commit to certain provisions that protect Frontier-Iowa's financial integrity. Article IV, Term 4 of the Settlement Agreement states that Citizens agrees and commits that the cost of capital as reflected in Frontier-Iowa's rates shall not be adversely affected by the result of Citizens' acquisition of Frontier-Iowa's stock. Citizens also agrees that subsequent to the completion of the stock purchase, the cost of capital for Frontier-Iowa in any future earnings analysis or rate base/rate-of-return rate case shall be set commensurate with the risk of Frontier-Iowa and shall not be affected by the stock purchase. Citizens agrees it will not oppose, in either a regulatory proceeding or an appeal of a decision by the Board, the application of the principle that the determination of the cost of capital shall be based on the risk attendant to the regulated operations of Frontier-Iowa. In addition, Citizens agrees that any decline in its credit ratings caused by the stock purchase shall be quantified in any future earnings analysis or rate base/rate-of-return rate case and adjusted as if such

declines did not occur. Finally, Citizens agrees to the use of an imputed or hypothetical capital structure in any future earnings analysis or rate base/rate-of-return rate case, if necessary to reflect the cost of capital for Frontier-Iowa without the effects of the stock purchase.

Citizens states that its ability to maintain a reasonable capital structure and to attract capital on reasonable terms will not be impaired because of this acquisition. Citizens asserts that it has a strong income statement and balance sheet, and Citizens' long-term debt was rated "A2" by Moody's. However, Mr. Lafferty updated his testimony at hearing stating that Moody's downgraded Citizens debt rating to a "Baa2." According to Mr. Lafferty, this is still considered an investment grade rating. In addition, Standard and Poor's has not changed Citizens' "A+" rating. Mr. Lafferty also states that it is Citizens' goal to remain at or above investment grade. This will be considered when reviewing future acquisitions such as in the development of Citizens' plan to acquire two million additional access lines.

One of the Board's main concerns in this case is why the agreement in this docket does not include all provisions included in prior settlements involving Global and Citizens. In Docket No. SPU-99-24, Global merged with Frontier Holding Company, the holding company of Frontier-Iowa and FCA. In Docket No. SPU-99-31, Citizens purchased several exchanges from U S West Communications, Inc., n/k/a Qwest Corporation (Qwest).

The Board finds that Citizens and the other parties have satisfied this concern. The evidence presented at the hearing shows that Citizens is an established company that has decided to focus its business on providing local exchange service to suburban and rural communities within the United States and that it has above investment grade debt rating. Global was a new company that operated in foreign markets with many projects still in progress and was just entering the local exchange business. The additional protections in the Global/Frontier agreement were required because Global was viewed as a risky company, especially in comparison to Frontier. The Board finds that Citizens, from a business and financial risk standpoint, is more comparable to Frontier and therefore the additional protections are not necessary.

The evidence shows that Citizens appears to be a more financially secure company. Citizens' business risk is lower, it has been in this industry for many years, it historically has maintained a strong balance sheet and income statement, it has an investment grade debt rating, a higher safety rating, and a higher rating for financial strength.

The Board finds also that the agreement in this reorganization protects Frontier-Iowa from any adverse effects this reorganization may have on Citizens including a downgrading in Citizens' debt rating. The Board also relies on Citizens' testimony at the hearing that it will not implement any future plans that would jeopardize its investment grade rating. The Board notes that Citizens has plans to acquire additional local exchange companies and there is the potential that its debt

rating may be downgraded. The Board believes that Citizens needs to act cautiously when considering any additional acquisitions.

The Board recognizes that Frontier-Iowa will not be operating with an optimal capital structure. Frontier-Iowa has a 100 percent equity ratio. Although this type of capital structure does not have any financial risk, it does not take advantage of the benefits of using debt financing, which is a cheaper source of funds. The Board believes that any problems that may occur because of this capital structure are protected against by the use of the hypothetical structure in future rate cases.

**3. WHETHER THE ABILITY OF THE PUBLIC UTILITY TO PROVIDE SAFE, REASONABLE, AND ADEQUATE SERVICE IS IMPAIRED. (476.77(3)"c")**

There are three provisions in the agreement that relate to this statutory factor.

1. The quality and reliability of the services provided by Frontier Communications of Iowa, Inc. (Frontier-Iowa) are of vital concern to Iowa customers and to the Iowa public. Citizens shall have first and principal responsibility for assuring that the quality and reliability of all such services are in no way slighted or compromised at any time following consummation of the transaction. Citizens commits and agrees, fully and without reservation, that the quality and reliability of all such services shall in all respects and at all times following consummation of the transaction be substantially preserved or enhanced.

2. Frontier-Iowa will utilize the reporting format attached as Exhibit 1 to facilitate assessment of compliance with the quality standards set forth in the Board's rules. This report will be submitted to Consumer Advocate and filed with the Board within thirty (30) days of the first two anniversary dates of the close of the transaction.

3. Frontier-Iowa will maintain its level of capital expenditures in Iowa at a minimum of \$90 per access line per year on average for two years after the sale of the stock.

The Board requested supplemental information to obtain assurances from Citizens that it would continue the specific upgrade projects promised by Global in Docket No. SPU-99-24. In Citizens' response, it indicates that it is committed to continuing the level of quality and reliable service provided by Frontier-Iowa through investments in infrastructure and maintaining levels of personnel. Citizens also states that it is committed to the same expenditure and deployment plans as Global.

Citizens provides the status of the upgrade projects planned for 2000 in the response. Citizens indicates that four exchanges would have Local Number Portability by the end of November 2000. By the end of 2000, four exchanges would have ASDL deployed. Thirteen of the 15 Digital Loop Carrier (DLC) projects indicated in Docket No. SPU-99-24 for 2000 are completed, with an additional five other projects completed in 2000, which were not previously indicated. The two projects not completed were due to lack of growth and need in those areas. Citizens states that seven fiber projects were completed in 2000. Citizens also states that it plans to complete 15 additional DLC projects and eight additional Fiber projects totaling about 65 miles in 2001. Citizens states that the \$90 per access line commitment



includes deployment of new services, including number portability, DSL, DLC, and fiber projects.

There were some concerns with service reliability and service quality raised in Docket No. SPU-99-31. The settlement in that docket contains many specific remedies if certain service levels are not met. Those assurances and remedies are not found in the agreement in this docket. However, in Docket No. SPU-99-31 it was found that some Qwest exchanges were not in compliance with 199 IAC 22.6. In the present case, the attachment to the agreement shows that Frontier-Iowa has exceeded the Board's service standards for the years 1998 and 1999. The Board expects Citizens to maintain compliance with 199 IAC 22.6 in the Frontier-Iowa exchanges.

The service quality reports filed as an attachment to the agreement show that Frontier meets or exceeds all Board standards established in the rules. The monitoring of the quality standards can be accomplished through review of the periodic reports promised in the agreement on the first two anniversary dates of the close of the transaction. Should the standards found in the Board's rules be violated, the rules also provide a remedy to the customer.

The Board finds that the agreement and commitments of Citizens support the ability of Citizens to provide safe, reasonable, and adequate service. Citizens has committed to continue the capital expenditures and upgrades of the Frontier-Iowa system agreed to by Global in Docket No. SPU-00-24. Citizens has agreed to the

expenditure of \$90 per access line for the next two years, and to provide quality of service reports. The reports show that Frontier-Iowa exceeds the quality of service requirements in 199 IAC 22.6. The Board will require that Citizens file a report on its system upgrades and its capital expenditures for the first two years when it files its quality of service reports.

**4. WHETHER RATEPAYERS ARE DETRIMENTALLY AFFECTED.  
(476.77(3)"d")**

A portion of Article IV, Term 4 of the agreement, also discussed in Statutory Factor #2, above, addresses the effect of the proposed capital structure on ratepayers. The settlement provides that if there is any future earning analysis, or rate base/rate of return rate case, an imputed or hypothetical capital structure will be used to reflect the cost of capital for Frontier-Iowa without the effects of the stock purchase. Citizens indicates that it is disposing of the non-telephone lines of business and will become solely a communications company. Citizens states that it is in the process of acquiring other local exchange carrier properties in 13 states, in addition to the purchase of the Frontier local exchange carriers. Citizens intends to focus its telecommunications operations in small-and medium-sized cities that are experiencing growth. Global's strategic plan calls for selling its LEC operations to focus on its global network and services business.

Citizens states that Frontier-Iowa rates and services are not affected by the change in the stockholder and the transaction will be transparent to customers and will have no immediate financial impact on the ratepayers. Citizens states that there

are no current plans to change the Frontier-Iowa name and it intends that the same people will serve the Frontier-Iowa customers and the existing local management and line staff will remain. Citizens also states that any transaction costs of the reorganization will be borne by shareholders.

Based upon the commitments of Citizens set out above, the Board finds that the ratepayers of Frontier-Iowa will not be detrimentally affected by the proposed sale. Frontier-Iowa operates under a price plan approved by the Board. The price plan has been renewed for five years in Docket No. RPU-00-4. Frontier-Iowa rates are regulated by the conditions of the price plan for the next five years.

Many of the issues to consider in this factor overlap considerations in the previous statutory factor. One specific instance is the protection of ratepayers in the Board's service quality rules, as discussed above. In addition, ratepayers should benefit by the assurance of system upgrades. The Board order requesting supplemental information questioned Citizens concerning its commitment to competition in the Frontier-Iowa exchanges. Citizens' response was that two interconnection agreements have been approved by the Board (CommChoice and Crystal Communications) since the Global/Frontier transaction. An additional competitor (Advanced Network Communications) is in the final review process of adopting an existing interconnection agreement.

**5. WHETHER THE PUBLIC INTEREST IS DETRIMENTALLY AFFECTED.  
(476.77(3)"e")**

The Board finds that all of the terms of the Settlement Agreement apply to the public interest. The public focus includes customers, stockholders, and regulators. Since the merger only directly affects stockholders, no direct change will occur for customers and regulators. Existing local management will remain after the completion of the merger.

Citizens is focusing its business on providing local exchange service and the transaction will be transparent to customers. Citizens has long participated in the local exchange market focusing on rural and suburban communities, which it believes have been under served by the current telecommunications market. The service territories of the Citizens and Frontier in Iowa are in close proximity. The increased size of the combined companies should result in reduction of time to market new service offerings. Citizens participates in sponsorship and other community interest activities and encourages its employees to be involved in volunteer and charitable activities as well.

The Board believes that Citizens is committed to providing appropriate access to its operational support systems (OSS), but that there has not been any demand for OSS access in the Frontier-Iowa exchanges. Citizens states that most of the competition for local exchange service in the Frontier-Iowa exchanges is expected to come from municipalities that will build their own facilities. Other competition is possible from wireless services. Citizens expects minimal requests by competitors to

use a portion of company facilities. For those requests received, the demand can be met through a manual-type system.

The Board finds that the sale of the Frontier-Iowa exchanges to Citizens will not have a detrimental effect on the public interest. The sale will put Frontier-Iowa under the control of a company whose primary business is local exchange service in rural and smaller municipal areas. Citizens has committed to upgrading the service in the Frontier-Iowa exchanges and has committed to maintaining the current management and staff. Considering the interests of customers, the public, and regulators, the sale will not detrimentally affect any of these areas.

#### **THE COMMUNICATION WORKERS OF AMERICA ISSUE**

As indicated above, the Board received an ex parte communication from CWA concerning the testimony of a Citizens witness at the hearing. CWA alleged that the witness did not respond truthfully to a question concerning retention of the pension plan fund by Global. The agency had previously returned an attempted ex parte communication by CWA. The Board issued an order that required the parties to brief two issues related to the ex parte communication.

The first issue is whether the matter of the retention of the pension funds by Global after the sale is material and relevant to the Board's review of the proposed reorganization. Citizens contends that the matter is not material and, since CWA did not intervene in this proceeding, the issue is not before the Board. Citizens points out that before the merger of Frontier Corporation (Frontier) with Global the pension

funds were held by Frontier, the parent corporation of Frontier Telco Subsidiary, Inc. In the sale of the Frontier companies to Citizens, no assets of Global, including the pensions, are being transferred.

Citizens states that the pension plan was frozen as of the end of 1996, and no further benefits will accrue under the plan, and the assets of the plan are protected by the Employee Retirement Income Security Act (ERISA). Citizens states that all of the requirements of the plan will be honored pursuant to federal law, and even if CWA had intervened, there is no basis for action by the Board. Finally, Citizens cites the decision by the Board in the U S West Communications, Inc. (U S West), merger with Qwest that the pension issues raised by retirees in that case were governed by federal law, Docket No. SPU-99-27.

Consumer Advocate also cites to the Qwest merger with U S West. Consumer Advocate points out that the Board in that case declined to attach terms and conditions to the merger to protect pensions after the merger. Consumer Advocate points out that the Board found there to be no direct connection between the merger and the pension plans. Consumer Advocate states that the difference in this proceeding is that Global will retain the excess in the pension fund, where in Docket No. SPU-99-27, the pension fund continued to reside in the post-merger entity. Consumer Advocate points out that CWA members will not in the future be able to collectively bargain for increased pension benefits from the excess.

The second issue is whether witness Peterson's testimony was complete and truthful. Citizens contends that when witness Peterson answered the Chairman's question concerning pensions, he did so truthfully. Citizens states that witness Peterson's response was to a question concerning the adoption of the union contract by Citizens. In addition, when the Chairman asked if the transition was seamless, witness Peterson responded that the pensions were included in the collective bargaining agreement, which was a complete and truthful response.

Consumer Advocate states that witness Peterson did not provide the information about the retention of the pension funds by Global and, to that extent, his response was not complete.

The Board finds that the issue concerning retention of the pension funds by Global raised by CWA is not properly before the Board. CWA did not intervene in the proceeding and, thus, has no standing to raise the issue. The issue came before the Board in the context of an ex parte communication, and this does not raise the issue to the level of competent and substantial evidence. In the current record there is no evidence from which the Board could make findings concerning the issue.

Additionally, the Board has addressed a similar issue in Docket No. SPU-99-27 and found that the Retiree Association, which was a party, had "failed to connect their issue to the merger in a direct substantive manner." There is a less direct substantive connection in this proceeding. To make a finding on this issue, the Board would have to ask for additional evidence from the parties, who have

stipulated to the other issues. CWA in its correspondence did not ask to intervene so it still would not be able to present any evidence in support of its position.

Since the Board has found that the pension issue is not a part of this case, the Board finds that it need not reach the issue of whether witness Peterson answered completely and truthfully. The Board notes that it believes that Consumer Advocate is correct that witness Peterson did not provide the information concerning the retention of the pension funds by Global, but the Board believes that the response may not have been called for by the Chairman's question.

### **CONCLUSION**

The Board finds, based upon the record in the proceeding and the terms and conditions of the "Settlement Agreement," that it should not disapprove the proposed sale. The Board will grant the joint motion to approve the "Settlement Agreement." The "Settlement Agreement" is reasonable in light of the whole record, consistent with law, and in the public interest. The reorganization will be permitted to take place by operation of law.

### **ORDERING CLAUSES**

#### **IT IS THEREFORE ORDERED:**

1. The motion to approve the proposed "Settlement Agreement" filed by Citizens Communications Company, Global Crossing Ltd. and the Consumer



Advocate Division of the Department of Justice on September 22, 2000, is granted and the settlement is approved.

2. Docket No. SPU-00-15 is terminated. The joint application filed by Global Crossing Ltd. and Citizens Communications Company on August 16, 2000, is not disapproved.

3. Global Crossing Ltd. and Citizens Communications Company shall promptly file with the Utilities Board any material changes to the proposed reorganization. Any such filing shall include an analysis of the impact of any changes.

4. Citizens Communications Company shall file with the Board quality of service reports required by the "Settlement Agreement," a report on capital expenditures and systems upgrades as described in this order.

**UTILITIES BOARD**

/s/ Allan T. Thoms

/s/ Susan J. Frye

ATTEST:

/s/ Sharon Mayer

Acting Executive Secretary, Assistant to

/s/ Diane Munns

Dated at Des Moines, Iowa, this 16<sup>th</sup> day of January, 2001